Pace Integrated Sys. v. RLI Ins. Co., No. 04-56688

REINHARDT, Circuit Judge, dissenting.

In California, exclusionary clauses in insurance contracts are strictly construed and "interpreted narrowly against the insurer." *State Farm Mut. Auto. Ins. Co. v. Partridge*, 10 Cal. 3d 94, 101-02 (1973). Along the same vein, "[t]he insurer bears the burden of bringing itself within a policy's exclusionary clauses." *HS Servs., Inc. v. Nationwide Mut. Ins. Co.*, 109 F.3d 642, 644-45 (9th Cir. 1997) (citing *Clemmer v. Hartford Ins. Co.*, 22 Cal. 3d 865, 880 (1978)). Because I think that the majority's disposition of this case inverts these fundamental principles of state law, while misapplying our precedent, I dissent.

Simply put, *HS Services* controls this case. There, we held that an employment-related practices exclusion much like the one in this case did not apply to an employer's allegedly defamatory remarks made in the marketplace about an ex-employee. *Id.* at 647. The *context* of the remarks – that they were uttered in the marketplace, not the workplace – was the dispositive factor governing our decision. *See, e.g.*, *id.* at 646 ("[T]he defamation is not 'clearly employment-related' because, although its content is directed to [the ex-employee's] employment, *the statements were not made in the context of [his] employment*." (emphasis added)); *id.* ("[T]he purpose of the remarks was to

protect [the employer] *in the marketplace*. The remarks related directly to *competition ... in the marketplace* and the [employer's] attempt to protect itself against a remark made by [the ex-employee], not as an ex-employee, but as a present competitor; that was their context." (emphasis added)).

We distinguished that case from *Frank and Freedus v. Allstate Insurance Co.*, 52 Cal. Rptr. 2d 678 (Cal Ct. App. 1996), another dispute concerning an almost identical insurance exclusion. In *Frank and Freedus*, an ex-employee sued his former law firm-employer for defamation based on statements a partner made after the employee had been fired. *Id.* at 680. The partner told the office manager that the ex-employee was "likely gay and probably has AIDS." *Id.* He also asked that the law firm's staff be informed that the "real reason" for the termination was the employee's "*failure to perform and develop as an associate*." *Id.* We held that the employment-related practices exclusion applied. *Id.* at 685.

In *HS Services*, we explained that the holding of *Frank and Freedus* was limited by this statement from that case: "The defamation here was clearly employment-related. The statement was made *in the context of [the ex-employee's] employment* and its content is directed to [his] performance during employment." 109 F.3d at 646 (quoting *Frank and Freedus*, 45 Cal. Rptr. 2d at 684) (emphasis added). We elaborated that, in *Frank and Freedus*, "the

defamatory remark was directly related to employment in that it related to the employer's attempts, *as employer*, to explain the termination to other employees; that was its context. It was 'clearly' an attempt by the employer, *as employer*, to bolster employee morale and, thus, was employment-related." *Id.* (emphasis added). We were emphatic in *HS Services* that "the difference in context" was what distinguished that case from *Frank and Freedus*. *Id.* We even characterized *Frank and Freedus* as establishing a "'context' require[ment]" for the application of employment exclusions, *id.* at 647 – that is, the alleged defamation must occur in the employment arena for the employment-related practices exclusion to apply.

Downplaying the crucial role of context, the majority seems to read into *HS Services* a requirement of provocation. That is, the majority concludes that a defamatory remark by an employer "arises out of" a termination of employment – and thus falls within an employment-related practices exclusion – unless the ex-employee provokes his former employer to respond. *See, e.g.*, maj. op. at 2 ("It is undisputed that Pace initiated the alleged defamations ... without provocation by either individual."); *id.* at 3 ("[N]othing in the record suggests that Pace's remarks were a response to false, or even true, statements about Pace ... in the competitive market."); *id.* at 4-5 ("Pace identifies no evidence ... that any action or statement by Gokbudak and Stairs broke the causal chain between their terminations and Pace's

alleged defamations.").

It is true that the employer in *HS Services* uttered the allegedly defamatory statements in response to remarks by its former employee. This does not mean, however, that we *must* find such provocation before applying the rationale and holding of that case. The relevant fact is not that the employer in *HS Services* made its remarks to *defend* itself in the marketplace – rather than to launch an offensive attack – but that it made its remarks *in the marketplace*, not in the workplace. Put another way, the crucial question is not, "Who started it?" but "Where did the fight occur?" If the fight broke out in the marketplace, as it did here, the employment-related practices exclusion does not apply.

The majority's approach shifts the burden to the insured to point to an intervening event that breaks the "chain of causation" between the termination and the remarks. Under California law, however, the burden of invoking an exclusionary clause falls on the insurer. In any event, contrary to the majority's conclusion, maj. op. at 3, a former employee's entrance into the marketplace as a competitor – the very event that carries the potential to transform the context from employment to competition – is surely sufficient to break the chain of causation for comments made to competitors and business associates.

In this case, Pace did not utter the allegedly defamatory remarks to "bolster

employee morale," *HS Servs.*, 109 F.3d at 646, to make an example of Gokbudak and Stairs to their former colleagues, or for any other employment-related reason. Pace made remarks to industry associates and competitors. These comments did not arise out of employment-related practices.[1] The majority's decision does violence to our controlling case law as well as to the rights of the insured, rights that by its rules of construction and its allocation of burdens California's public policy seeks to protect against unsympathetic courts. I dissent.

[1] For the same reasons, RLI's attempt to invoke the "breach of contract" exclusion is also unavailing.